



United States Department of the Interior



MINERALS MANAGEMENT SERVICE
Minerals Revenue Management
P.O. Box 25165
Denver, Colorado 80225-0165
www.mrm.mms.gov

MMS/MRM/RIK
Mail Stop 330B2

Dear Operator:

The Minerals Management Service (MMS) has selected one or more offshore Federal leases in the Gulf of Mexico (GOM), which you operate, to be included in the Royalty In-Kind (RIK) program where we will take crude oil and condensate royalty production in-kind beginning July 1, 2007. For RIK lease information that does not pertain to these crude oil sales, please see our website at <http://www.mrm.mms.gov/rikweb/RIKOperLts.htm>. **It is your responsibility to notify the applicable working interest owners of this decision.**

This letter provides the procedures and establishes the terms and conditions under which the United States (Lessor) will take crude oil royalties in-kind. Our authority is the Outer Continental Shelf Lands Act of 1953 (43 U.S.C. § 1353) and the royalty provisions contained in your Federal lease. For purposes of this letter, royalty oil means the Federal lease oil and condensate production multiplied by the lease royalty rate.

Term

The Lessor will take all royalty oil in-kind from your properties flowing to the Facility Measurement Point(s) (FMP) listed in Enclosure 1, beginning July 1, 2007, and will continue taking royalties in-kind until we notify you that the in-kind status is terminated. We will provide Operators with at least a 45 day prior written notice when terminating the in-kind status.

Lessor and Lessor's Designee

The Lessor may act by or through a duly authorized Designee. Enclosure 1 provides MMS' Designee at each custody transfer point. The Designee will agree in writing to comply with all provisions of this letter that are applicable to the Lessor when the Designee acts on our behalf. You are required to direct communications to the Lessor and our Designee. We will provide written notification when the Designee changes or is no longer authorized to act on our behalf for the purposes of this letter.



Royalty Oil Delivery

The delivery points for royalty oil produced from the properties are identified in Enclosure 1. It is your responsibility to ensure that royalty production from any of your properties that is actually flowing to the designated FMP on any given month will be delivered in-kind to the Lessor or Designee, with the exception of Royalty Relief and Section 6 leases (unless otherwise noted), State leases, or Net Profit Share leases. The Lessor or Designee will take custody and responsibility for royalty oil at the delivery point.

You can be reimbursed for transportation and quality bank debits and/or quality differentials associated with royalty oil delivery to points identified in Enclosure 1 that are downstream of the FMP in accordance with the applicable MMS regulations. In addition, you must pay MMS for any quality bank credits received associated with royalty oil delivery to points identified in Enclosure 1 that are downstream of the FMP in accordance with the applicable MMS regulations. You will be required to report quality bank debits and credits for properties where the quality bank is passed back to the operator/producer or where a quality differential exists on a pipeline where there is not an instituted quality bank, as allowed in applicable MMS regulations. Please use the applicable GravCap tables to calculate the quality differential on pipelines where there is not an instituted quality bank. If gathering upstream of the FMP is approved by MMS, you may take this deduction, as well as other related fees, on the Report of Sales and Royalty Remittance (Form MMS-2014).

Royalty oil must be placed in marketable condition at no cost to the Lessor. Marketable condition means the condition generally acceptable to purchasers in the field or area. Questions on marketable condition should be directed to the Lessor's points of contact identified in this letter.

You must deliver all royalty oil from the selected leases, including royalty oil from newly producing wells on these leases. During the in-kind period, you will make your best effort to notify the Lessor's designated point of contact of new oil production flowing to the FMP identified in Enclosure 1. Royalty oil from this new oil production may be added to the RIK volumes at the existing delivery points by the Lessor.

Fulfillment of Royalty Obligations

Delivering the accurate volume of royalty oil, taking into account the effects of normal operational imbalances, in accordance with the terms of this letter will satisfy in full the Lessee's royalty obligation to the Lessor.

All rent or minimum royalty obligations remain the responsibility of the Lessee. If the Lessee owes minimum royalties, the Lessor will issue a bill including information supporting the calculation. The Lessee will have 30 days to review the bill and make payment or appeal the bill.

Lessor's Obligation to Take

Lessor agrees to take 100 percent of the royalty oil delivered to the delivery point for the account of the Lessor. Lessor, using customary industry practices, will exercise its best efforts to minimize

the occurrence of imbalances with you and the Lessees.

To facilitate timely and accurate custody transfer of royalty oil, Lessor will communicate with you regarding arrangements to transfer the royalty oil from the delivery point. The Lessee will not incur royalty-related penalties because of the Lessor's failure to take delivery of oil volumes as communicated by the Operator.

Communication Between Parties

With the exception of those properties where the Lessor ships their barrels, the Lessor will no longer notify the Designee of the daily royalty oil volumes anticipated for the following month of production. The Designee will be responsible for obtaining this information from the FMP operators. The Designee, as the Lessor's designated agent, will communicate directly with the FMP operator, obtain estimated volumes, and make arrangements for the delivery and transfer of royalty oil from each custody transfer point identified in Enclosure 1.

The estimated delivery volumes must be obtained from the responsible FMP operator no later than 10 business days before the first day of each month. The Designee will provide the estimated delivery volumes for each custody transfer point to the Lessor by noon MT the 21st of each month. When the 21st falls on a weekend or Federal holiday, the following business day applies. This process will continue for each month in accordance with the "Term" stated above.

For only SPR packages 1, 11, and 30-35 where the Lessor ships their barrels, you must notify the Lessor in writing via facsimile at 303-231-3846 or e-mail addressed to rik.project@mms.gov of the daily royalty oil volumes (Avails) anticipated for the following month of production by noon MT on the dates shown in Enclosure 2 for each of the properties identified in Enclosure 1. Enclosure 3 provides the recommended Avails form. This form is also available at http://www.mrm.mms.gov/rikweb/ExcelDocs/Oil_Production_Avails_Estimate.xls. On this same form for each property, you will also provide any anticipated volume adjustments to resolve previous months' imbalances. The total volumes to be delivered to our Designee at each of the delivery points must be indicated as a volume net of anticipated production plus or minus any adjustments. The Lessor understands that any such estimates are not warranties of actual deliveries but are provided to facilitate planning.

For all other packages, communications with the Lessor's Designee must occur regarding the daily royalty oil volumes anticipated for the following month of production.

You must use reasonable efforts, consistent with industry practice, to inform both the Lessor and the Designee as soon as practical regarding significant changes to the information listed in Enclosure 1; for example, oil production levels for the RIK contract properties, as well as if the property was sold and to whom it was sold.

Volume Reconciliation

You must provide the pipeline with the volume allocation for MMS' royalty oil separately from other producers.

You must send all volume allocation schedules provided to pipeline companies that address royalty oil volumes at the delivery points in Enclosure 1 to the Lessor **at the same time they are submitted to the pipeline companies**. Volume allocation schedules must be submitted to the rik.project@mms.gov mailbox. Enclosure 4 provides the recommended volume allocation form.

This form is also available online at http://www.mrm.mms.gov/rikweb/ExcelDocs/Actual_Production_Allocation_Form.xls.

Operator Assignments

For leases which are being taken in-kind and which you are assigning to another Operator, you must notify the Designee and the Lessor point of contact described under “New Lease Production” of those assignments. In addition, you must notify only the Lessor point of contact described under “New Lease Production” of the effective date of the assignment (Operator change date with MMS), and identify which company assumed the existing imbalances at the time of assignment. Any ending imbalance existing at the effective date of the assignment will be cashed out as described under “Balancing Account and Imbalances.”

Balancing Account and Imbalances

You will take timely action to remedy potential imbalances through adjustments to royalty oil volumes delivered to Lessor in the production month following the month the imbalance is created.

Imbalances between delivered and entitled volumes of royalty oil will be jointly monitored by you and Lessor. Such volume adjustments will be identified in your communication of royalty oil volumes anticipated **before** the month of production as described under “Communication Between Parties.”

Requirements for handling routine imbalances are outlined below:

- Imbalances will be determined on the basis of the difference between the entitled royalty share of production and the actual volumes delivered. These imbalances will be maintained at a lease/agreement level.

You must make available upon request by MMS the lease imbalance statement to the Lessor point of contact, as described under “Operator Imbalance Statements”. The lease imbalance statement must be available within 45 days after the end of the month of production unless Lessor approves an alternative timeframe. We will monitor and reconcile royalty entitlements with the royalty oil deliveries you make. Your imbalance statement must specify total production, MMS’ entitled share, volumes delivered, the monthly imbalance, and the cumulative imbalance. Enclosure 5 provides the recommended Oil Imbalance Statement Form. This form can also be found online at http://www.mrm.mms.gov/rikweb/ExcelDocs/Oil_Imbalance_Statement.xls

You will remedy imbalances in the production month following the month that the imbalance is

identified. Routine imbalances not remedied within 90 days of the end of the production month will be resolved as follows:

- Mutually agreed upon make-up delivery schedule.
- If mutual agreement is not reached, cash out payment based on the Lessor's contract price (at the delivery point), net of transportation costs, from the lease for each month of the imbalance. Interest will accrue from the end of the month following the month of production.

In extraordinary imbalance situations, cash out payment is based on the Lessor's sales price net of transportation costs from the lease for each month of the imbalance.

Reconciliation will involve communication between you and the Lessor. Upon project termination, you must issue a final oil imbalance statement. Imbalances remaining upon cessation of the RIK term or cessation of production will be settled on the basis of the Lessor's contract price (at the delivery point), net of transportation costs, from the lease for the final month of in-kind delivery. You will report the imbalance volume and value on the Form MMS-2014 as either a positive or a negative for the final month of delivery. Interest will accrue from the end of the month following the month of production.

Reporting

You must continue to report crude oil production on the Oil and Gas Operations Report (OGOR). You must also report transportation allowances and quality bank debits/credits on the Form MMS-2014 for any royalty volumes that are delivered downstream of the FMP or where the quality bank is passed back to the operator/producer under requirements specified in the MMS regulations and the MMS *Minerals Revenue Reporter Handbook*, please see our website at <http://www.mrm.mms.gov/ReportingServices/PDFDocs/RevenueHandbook.pdf>.

You will not be required to report royalties for the RIK properties listed in Enclosure 1 on the Form MMS-2014 for the term during which the Lessor takes royalty in-kind, with the exception of properties noted as Royalty Relief and Section 6 leases (unless being taken in-kind), Net Profit Share, and any retrograde or free condensate not delivered to the Lessor. You must continue to report these non-RIK properties on the Form MMS-2014 per the MMS regulations.

Audit

The Lessor may audit your records regarding all information relevant to volumes and qualities of royalty oil produced, measured, delivered, and if applicable, transported. We reserve the right to examine your financial records for the subject properties related to any transportation allowances and quality banks prior to the delivery point.

Lessees, Operators, and revenue payors must maintain all records of transactions mentioned in the above paragraph in accordance with the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (Public Law 104-185 Section 115(f)).

Lessor's Point of Contact

Copies of all correspondence between the Operator and Lessor should be kept on file by the Operator. Points of contact for the Lessor are listed below:

- Volume Allocation Schedules, Operator Imbalance Statements, and Minimum Royalty Obligations:

Ms. Bernie Muniz
Telephone: 303-231-3854; Fax: 303-231-3846
E-mail: Bernadette.Muniz@mms.gov

- Volume Avails (Anticipated Volumes for SPR Packages 1, 11, and 30-35):

Ms. Verlene Butts (Unrestricted Avails)
Telephone: 303-231-3159; Fax: 303-231-3846
E-mail: Verlene.Butts@mms.gov

- New Lease Production:

Ms. Donna Hogan (BON, POS, EI, SGC, LLS, TXG)
Telephone: 303-231-3148; Fax: 303-231-3846
E-Mail: Donna.Hogan@mms.gov or

Mr. Allen Vigil (Mars, Grand Isle, HLS, HLS-SB, HOOPS, Santa Ynez)
Telephone: 303-231-3098; Fax: 303-231-3846
E-Mail: Allen.Vigil@mms.gov

- Electronic Funds Transfer:

Mr. David Barnes
Telephone: 303-231-3034; Fax: 303-231-3501
E-mail: mailto:David.Barnes2@mms.gov

- Marketable Condition Questions:

Mr. Roman Geissel
Telephone: 303-231-3226; Fax: 303-231-3473
E-mail: Roman.Geissel@mms.gov

- MMS RIK Website: <http://www.mrm.mms.gov/rikweb/Default.htm>

We acknowledge that you and the Lessees have given proper notice when using the telephone number or fax number provided to communicate with us. Any telephone communication regarding volumes must be confirmed by e-mail or fax no later than 1 business day after telephone communication occurs. We further agree to make arrangements to receive such communications regarding oil scheduling issues during normal business hours. You and the Lessees should communicate with one of the points of contact to answer any further questions.

The Paperwork Reduction Act

The OMB Control Number for this Dear Operator Letter is 1010-0119 with an expiration date of February 28, 2009, respectively. The PRA (44 U.S.C. 3501 et seq.) requires us to inform you that we collect this information to document fulfillment of royalty obligations on minerals removed from Federal lands. The MMS uses the information to maintain and audit lease accounts. Responses are mandatory (43 U.S.C. 1334). Proprietary information is protected in accordance with standards established by the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1733), the Freedom of Information Act (5 U.S.C. 552(1), (4)), and the Department regulations (43 CFR 2). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB Control Number. Public reporting burden for this form is estimated to average one hour per response, including the time for reviewing instructions, gathering and maintaining data, and completing and reviewing the form. Direct comments regarding the burden estimate or any other aspect of this form to the Information Collection Clearance Officer, Minerals Management Service, Mail Stop 4230, 1849 C Street, NW., Washington, DC 20240.

Sincerely,



James D. Steward
Manager, Crude Oil Marketing
Royalty In-Kind

Enclosures:

- Enclosure 1 July 2007 RIK Properties
- Enclosure 2 Summary of Nomination Due Dates
- Enclosure 3 Oil Production Avails Estimate
- Enclosure 4 Actual Operator Delivery Allocation
- Enclosure 5 Oil Imbalance Statement